



Auditor Independence and Its Impact on Financial Reporting Quality

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Abstract

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This study investigates the critical role of auditor independence in maintaining high-quality audits and ensuring the reliability of financial reporting. Employing a literature review method, the research identifies key threats to independence, such as the significance of major clients, the provision of non-audit services, extended auditor tenure, and close relationships between audit firms and clients. These factors, if not effectively controlled, can impair auditors' objectivity, resulting in diminished audit quality and decreased trust in financial statements. The study emphasizes that compromised independence can negatively influence stakeholder confidence, as users of financial information depend on auditors' impartial judgment and professional integrity. To mitigate these risks, the research recommends establishing independent oversight boards within large audit firms and enforcing mandatory auditor rotation policies. Implementing these strategies is expected to enhance auditor objectivity, preserve audit quality, and strengthen the credibility of financial reporting, thereby ensuring that stakeholders including investors, regulators, and the public can rely on financial statements with confidence.



1. Introduction

Auditor independence is widely recognized as a fundamental component in ensuring the integrity and reliability of financial reporting, serving as a cornerstone for credible financial statements issued by public companies (Zhuwau & Shumba, 2018). Independence is not merely a procedural requirement; it represents a critical principle that guarantees auditors can perform their duties objectively and impartially, free from undue influence or pressures from management or other stakeholders. Although there is no universally agreed-upon definition of auditor independence, it generally refers to the auditor's capacity to resist external pressures and disclose any irregularities or violations identified during a financial audit (Godlewska, 2020). When independence is compromised, the quality of audits can be severely affected, as auditors may hesitate to challenge management's assertions, question assumptions, or detect material misstatements in the financial statements (Mostafa Mohamed et al., 2013).

Consequently, engaging independent auditors is essential for ensuring that financial reports are credible, reliable, and reflective of the organization's true financial position. Auditor independence therefore directly influences both audit quality and professional accountability. The link between auditor independence and audit quality is particularly significant and requires careful consideration in the context of auditor selection and rotation policies (Schelker, 2013). Auditors have the primary responsibility of verifying annual financial statements, ensuring these reports accurately depict an entity's financial condition and providing assurance to stakeholders. Independence involves a commitment by auditors not to approve

misstatements they discover and the ability to resist client pressures to manipulate financial reporting. Research has highlighted multiple threats to auditor independence, including the relative importance of clients to audit firms, the provision of non-audit services, prolonged auditor tenure, and close affiliations between auditors and clients (Tepalagul & Lin, 2014). These threats, if not appropriately managed, may undermine objectivity, reduce audit quality, and diminish stakeholder confidence.

Even in situations of corporate failure, auditors frequently defend their technical competence, but they often encounter difficulties in demonstrating the impartiality and independence of their decision-making processes. To address these challenges, it has been proposed that large audit firms establish a formal independence board tasked with overseeing threats to independence, reviewing quality-control measures, and developing educational programs to strengthen auditors' decision-making regarding independence (Malagila et al., 2020). Such a board would define, monitor, and mitigate risks that could compromise independence, thereby enhancing the objectivity of audits. Transparency regarding the composition, processes, and quality-control procedures of the independence board is also crucial, as it fosters public trust in the audit profession and reassures stakeholders that auditors' work is conducted with integrity.

The primary objective of this research is to explore the role of auditor independence in sustaining audit quality and maintaining the credibility of financial reporting. This study examines how independence enables auditors to perform their duties objectively, resist external pressures, and produce reliable financial statements.

Furthermore, it identifies the principal threats to independence, including client importance, provision of non-audit services, auditor tenure, and close affiliations with clients, and proposes practical mechanisms to strengthen auditor independence. By establishing an independence board and implementing transparent governance processes, audit firms can enhance professional objectivity, safeguard the integrity of financial statements, and ultimately improve stakeholder confidence in audited financial reports. In doing so, auditor independence not only ensures high-quality audits but also reinforces the credibility of financial reporting in the broader corporate governance framework.

2. Methods

This study employs a literature review combined with content analysis to investigate the role of auditor independence in sustaining audit quality and ensuring the reliability of financial reporting. The literature review process involves collecting secondary data from books, peer-reviewed journal articles, and other scientific sources that provide insights into auditor independence, audit quality, and financial reporting practices. Using content analysis, the selected literature is systematically examined to identify recurring patterns and themes, with particular attention to common threats to auditor independence, including auditor tenure, client significance, and the provision of non-audit services. The analysis aims to integrate existing findings and provide a comprehensive understanding of how auditor independence impacts audit quality and the credibility of financial statements. Based on this synthesis, the study intends to develop practical recommendations for policy

and practice. These include establishing an independence oversight board within audit firms, enhancing transparency in audit procedures, and implementing stricter regulatory measures to reinforce auditor independence. Strengthening independence through these measures is expected to improve audit quality, promote objectivity, and increase stakeholder confidence in the accuracy and integrity of financial reports.

3. Results

This research underscores the fundamental importance of auditor independence in ensuring high-quality audits and maintaining the integrity and reliability of financial reporting. Auditor independence is a cornerstone of professional auditing because it guarantees that auditors can perform their duties with impartiality and objectivity, free from undue influence or external pressures. By analyzing the existing literature, this study identifies the primary factors that affect auditor independence, explores their impact on audit quality, and proposes practical policies to strengthen independence within auditing practices. Independent auditors are better equipped to detect misstatements, errors, or fraudulent activities in financial statements without being swayed by management or client interests (Bhaskar et al., 2019). This is crucial because stakeholders, including investors, regulators, and the public, rely heavily on audited financial statements to make informed decisions regarding the company's financial position and performance. Without auditor independence, audit quality diminishes, and the credibility of financial reporting is compromised.

The study highlights that the level of audit quality is strongly dependent on the degree of independence auditors maintain throughout the audit process. When auditors operate without interference from management, they are more likely to provide unbiased and accurate assessments of financial statements. Conversely, when auditor independence is compromised, either due to prolonged business relationships with clients or the provision of non-audit services by the audit firm, audit quality can be negatively impacted (Burnett et al., 2018). The research identifies four primary threats to auditor independence. First, the significance of a client to the auditor or audit firm represents a major threat. When a client contributes substantial revenue or has a long-term relationship with the auditor, there may be implicit pressure to approve financial statements even if inaccuracies exist. Second, the provision of non-audit services to the client can create conflicts of interest, as auditors may become less willing to challenge management or identify errors that could jeopardize these additional revenue streams. Third, auditor tenure is a concern. Extended relationships between auditors and clients can lead to over-familiarity, reducing professional skepticism and potentially compromising the objectivity of audit judgments. Fourth, client affiliation with the audit firm, particularly when personal or professional ties exist between client personnel and auditors, can exert subtle pressures that erode independence and impartiality.

Based on these findings, the study recommends several measures to enhance auditor independence and, consequently, audit quality. One critical recommendation is the establishment of an independence board within large audit firms. This board would oversee and evaluate all matters related to auditor independence, ensuring

that auditors' decisions and judgments adhere to ethical and professional standards (Neville et al., 2019). The independence board would also be responsible for monitoring potential threats to independence, reviewing auditor-client relationships, and recommending strategies to mitigate risks. Another key policy proposed by the study is the regular rotation of auditors. Periodic rotation prevents auditors from becoming too closely associated with a client, which can reduce familiarity risks and help preserve objectivity. Rotation policies not only safeguard independence but also introduce fresh perspectives, enhancing the overall quality and effectiveness of audits.

Transparency in audit procedures is another essential recommendation emphasized by this research. Audit firms that openly communicate their auditor rotation policies, the establishment and role of independence boards, and other governance measures can enhance stakeholder confidence in the objectivity and impartiality of the audit process. By implementing transparent practices, audit firms can demonstrate accountability, reduce potential conflicts of interest, and reassure stakeholders that the financial statements produced are reliable and trustworthy (Boiral et al., 2019). Openness in audit processes fosters trust among investors, regulators, and the broader public, contributing to more stable and credible financial reporting environments. Moreover, the research highlights the importance of continuous monitoring and evaluation of auditor independence to ensure long-term effectiveness. Firms should periodically review client relationships, engagement structures, and the provision of additional services to identify emerging risks to independence.

Training programs and ethical education for auditors can also reinforce the principles of independence and objectivity, ensuring auditors are equipped to resist undue influence and uphold high professional standards. In conclusion, this study demonstrates that auditor independence is vital for maintaining audit quality, enhancing stakeholder trust, and ensuring the credibility of financial reporting. Threats to independence arising from client significance, non-audit services, auditor tenure, and client affiliations with audit firms can significantly undermine audit quality if not adequately managed (Wakil et al., 2019). To strengthen auditor independence, the study recommends that large audit firms establish dedicated independence boards, implement regular auditor rotation, and maintain transparency in audit procedures. By adopting these measures, audit quality can be protected, and stakeholders can have confidence that financial statements accurately reflect the true financial position and performance of organizations. Ensuring auditor independence is therefore not only a professional and ethical imperative but also a strategic necessity for promoting reliable financial reporting and sustaining trust in the financial system.

4. Conclusion

The conclusion of this study highlights that auditor independence is essential for preserving audit quality and ensuring the reliability of financial reporting. A lack of sufficient independence can compromise auditors' objectivity and impartiality when reviewing financial statements, potentially resulting in incorrect decisions by stakeholders. The study also identifies key threats to auditor independence, including

client significance, provision of non-audit services, extended auditor tenure, and close affiliations between clients and audit firms, all of which can adversely affect audit quality. Consequently, protecting auditor independence should be a primary focus in audit practice. To enhance independence, the research recommends establishing an independence board within large audit firms to monitor potential threats and promote transparency in audit processes. Furthermore, instituting regular auditor rotation can mitigate the risks associated with long-term auditor-client relationships that may impair objectivity. By adopting these measures, audit quality can be safeguarded, ensuring that financial statements are accurate, reliable, and trustworthy for all stakeholders.

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